No. 15349

IN THE

United States Court of Appeals

FOR THE NINTH CIRCUIT

Jefferson Standard Life Insurance Company, a corporation,

Appellant,

vs.

United States of America, H. L. Byram, County Tax Collector of Los Angeles County, and George T. Goggin, Trustee of Stockholders Publishing Company, Inc., a corporation, Bankrupt,

Appellees.

APPELLANT'S OPENING BRIEF.

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TOPICAL INDEX

TABLE OF AUTHORITIES CITED

Statutes

Textbooks

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APPELLANT'S OPENING BRIEF.

Jurisdiction for Review.

This appeal is by Jefferson Standard Life Insurance Company from an order of the District Court [R. 39] affirming an order of Referee in Bankruptcy David B. Head [R. 23] upon appellant's petition for review [R. 32]. Jurisdiction is conferred upon this court by Section 24 of the Bankruptcy Act, 11 U. S. C. A. 47. The amount involved is in excess of $500.00.

Statement of the Case.

This appeal will give this court an opportunity to clarify the law on two important questions: the problem of so-called "circular priorities," and the problem of the allowance of post-bankruptcy interest on secured claims.

Petition in bankruptcy was filed December 31, 1954.

Real and personal property of the bankrupt was sold free and clear of liens for $382,500.00 and sale confirmed on April 29, 1955, liens being transferred to the proceeds of sale with the acquiescence of all parties.

The liens ranked in the order of time as follows:

Claimant	Kind of Lien	Date Attached	Amount at Date of Bankruptcy
Jefferson Standard	Chattel mortgage trust deed and assignment.	December 1, 1945	$351,223.74
United States	Corporate income and excess profits taxes and penalties on federal insurance contribution taxes.	March 14, 1952	288,608.58
Los Angeles County	Real and personal property taxes.	March 1, 1954	15,384.10

Jefferson Standard's deed of trust was in default before bankruptcy, declaration of default having been filed on December 23, 1954 [R. 59-62].

It appears that the amount realized from the sale of the security was more than sufficient to pay Jefferson Standard's claim with interest to the date of payment, and in addition to pay the claim of Los Angeles County, although it is not sufficient to pay all lien claims in full.

Jefferson Standard's lien is first in time, and it is undisputed that it is entitled to priority over the federal tax lien, notice of the federal lien not having been recorded until December 20, 1954. The federal lien precedes the lien of Los Angeles County in point of time.

Recognizing the priority of Jefferson Standard's lien, the Referee ordered payment of its claim in the amount of $351,223.74 (principal and interest to the date of bankruptcy), but ordered the deduction of $15,384.10

to pay the tax claim of Los Angeles County, applying state law, which he thought made the County's lien superior to the mortgage lien. Jefferson Standard received payment of $335,839.64 on September 1, 1955. The $15,384.10 deducted to pay county taxes has been retained in the custody of the court. The order further provides that if anything is left after the lien of the United States has been fully satisfied, Jefferson Standard will then receive the balance of $15,384.10 secured by its lien.

The result is that the lien of Los Angeles County (which is last in time) will be paid in full out of Jefferson Standard's money, and will be paid ahead of the prior mortgage lien and ahead of the federal tax lien. The federal tax lien will be paid before Jefferson Standard's lien is paid in full, in spite of the fact that the federal tax lien is clearly inferior to the mortgage lien under federal law.

Jefferson Standard contends that its antecedent mortgage lien is entitled to priority of payment over the County tax lien under state law as well as under federal law, but that in any event the Referee should have applied federal law and not state law to determine the priorities. Under federal law Jefferson Standard would be paid first, then the United States, and Los Angeles County last of all, under the rule "first in time, first in right."

The Referee also disallowed Jefferson Standard's claim to interest from the date of bankruptcy to the date of payment, this claim amounting to $10,657.74. Jefferson Standard contends that since the proceeds from the sale of its security were more than sufficient to pay both principal and interest on its claim, interest should have been allowed up to the date of payment of the claim.

Specifications of Error.

Appellant specifies the following as error:

1. The Referee's orders erroneously and inequitably denied appellant's claim for interest after the date of filing of the petition in bankruptcy.

2. Said orders erroneously and inequitably subordinated payment of appellant's claim to the extent of $15,384.10, not only to payment of the claim of the County of Los Angeles for real and personal property taxes but also to the claim of the United States for income and excess profit taxes and penalties on withholding and federal insurance contribution taxes.

3. Said orders erroneously and inequitably denied to appellant's lien priority over the liens of the County of Los Angeles and the United States.

4. Said orders erroneously and inequitably gave the lien of the United States priority over the lien of appellant to the extent of $15,384.10.

5. Said orders erroneously and inequitably gave the lien of the County of Los Angeles priority over the lien of appellant.

6. The Referee committed error in applying state law to determine the priority of the liens of appellant and the County of Los Angeles.

7. The Referee committed error in determining that the law of California gave the lien of the County of Los Angeles for real and personal property taxes priority over the lien of appellant's mortgage and deed of trust.

8. Said orders erroneously gave the lien of the County of Los Angeles for real and personal property taxes priority over the lien of the United States for income and excess profits taxes and penalties on withholding and federal insurance contribution taxes.

ARGUMENT.

The first question presented by this appeal is that of the relative priority of federal tax liens, local tax liens, and a contract lien, where the contract lien is superior to the federal liens, and the fund is sufficient to pay the contract and local tax liens but not to pay all liens.

It is conceded that the lien of Jefferson Standard is superior to the federal lien.

The county contends that its lien is ahead of Jefferson Standard's, but Jefferson Standard contends that its lien is ahead of the county's.

Jefferson Standard contends that federal law controls the order of payment. The United States and the county contend that state law changes federal law.

If either of Jefferson Standard's contentions is sustained, it is entitled to be paid the funds deducted from its allowed claim and held for payment to the county.

We submit that the problem of "circular priorities" which has been supposed to arise in this situation is a problem which the Referee and the District Court in the case at bar and some other courts have created for themselves by ignoring applicable law. Certain cases illustrate an apparent judicial inclination to order local tax liens paid in full out of funds "set aside" for the payment of the contract lien, paying mere lip service to the acknowledged superiority of the contract lien under federal law. Those judges who have yielded to this impulse have usually justified the result by calling it the "most equitable" way out of their dilemma.

Actually, this solution is not equitable at all, and can only be justified as vindicating state sovereignty. Yet,

this is a case in which there is no room for the exercise of state sovereignty. This is so for two reasons. Federal law is supreme in bankruptcy administration. Federal law is also supreme wherever a federal tax lien is involved. Federal law accordingly should have been applied in this case.

Federal law, as declared in 1954 by the United States Supreme Court in *United States v. New Britain,* 347 U. S. 81, 98 L. Ed. 520, 74 S. Ct. 367, establishes the rule "first in time, first in right." This rule recognizes the superiority in equity of a senior lien over all other liens that are later in time, and is the universal rule in the absence of special statute.

"Circularity" arises only when controlling principles of law are ignored, or are not consistently applied. There can be no conflict between state law and applicable federal law, when federal law is the supreme law of the land. There can be no conflict between appellant's lien and a local tax lien, when the superiority of appellant's lien is established by supreme law. The Referee created the "conflict" of liens when, after he had recognized the superiority of appellant's lien under federal law, he then proceeded to ignore it and applied state law instead.

The Referee's order is erroneous and should be reversed because it ordered satisfaction of the local tax lien according to state law. His order is self-contradictory and directly contrary to federal law, as is illustrated by the fact that according to his order the federal lien will be fully satisfied before appellant gets the last $15,384.10

of its money (if it ever does), although by federal law the government's lien is inferior to appellant's lien.

The Referee's order was based on his assumption that there was in fact a conflict between the liens of appellant, the County of Los Angeles, and the United States. A moment's reflection will show that this assumption was incorrect.

The Referee utterly failed to appreciate the significance of the fact that the fund was sufficient to pay both appellant's claim and the County's claim in full. There was no conflict between appellant's lien and the federal lien, because by federal law appellant's lien is admittedly superior to the federal lien. There was no conflict between appellant's lien and the county's lien, because the fund was ample to pay both. The Referee should have ordered appellant's lien paid in full. *Conflicting claims to the surplus* would then arise between the County and the United States. The surplus should have been ordered paid to the United States, whose claim is superior to the County's claim by reason of its priority in time and the supremacy of federal law.

Instead of so ordering, the Referee made the truly astonishing order that the County tax claim should be paid in full out of appellant's money, and that the claim of the United States should be paid in full before appellant's prior mortgage is fully satisfied!

There is no logical basis for such an order. It is apparent that the Referee used the fiction of a conflict between liens as justification for his failure to enforce the

superiority of the government's lien over the County's lien. There was, in fact, no such conflict. The real basis for the decision was the Referee's reluctance to deprive the County of Los Angeles of the flow of its "life blood" [R. 18].

As an additional ground for reversal of this part of the Referee's order, we further submit that by state law the County Tax Collector's lien is not paramount over appellant's lien, as the Referee erroneously assumed it to be. The California legislature could have passed a statute making state tax liens paramount over contract liens, as have the legislatures of other states, but it has never done so. The statutes and decisions on which the County Tax Collector relied relate solely to the effect of tax deeds, and are not relevant here where there has been and will be no tax deed, and the question is solely one of priority.

The second question presented by this appeal is that of the allowance of post-bankruptcy interest on a secured claim. Dicta of this court in *Beecher v. Leavenworth State Bank,* 192 F. 2d 10, have been taken by district judges and referees in the Ninth Circuit as establishing a rule that post-bankruptcy interest may not be allowed on a secured claim, although the security is more than ample. We do not believe this result was intended by this court or is required by its decisions, and suggest that it take this opportunity to explain and reconcile its decisions and thereby bring the rule in the Ninth Circuit into line with the decisions of the Supreme Court and the great weight of authority in other circuits, which allow post-bankruptcy interest when the security is sufficient.

I.

Federal Law, Not State Law, Controls in Bankruptcy Administration and in Any Case Concerning a Federal Tax Lien.

Vanston Bondholders Protective Committee v. Green, 329 U. S. 156, 91 L. Ed. 162, 67 S. Ct. 237 (1946):

> "In determining what claims are allowable and how a debtor's assets shall be distributed, a bankruptcy court does not apply the law of the state where it sits. Erie R. Co. v. Tompkins, 304 U. S. 64, 82 L. Ed. 1188, 58 S. Ct. 817, 114 A. L. R. 1487, has no such implication. That case decided that a federal district court acquiring jurisdiction because of diversity of citizenship should adjudicate controversies as if it were only another state court. See Holmberg v. Ambrecht, 327 U. S. 392, 90 L. Ed. 743, 66 S. Ct. 582, 162 A. L. R. 719. But bankruptcy courts must administer and enforce the Bankruptcy Act as interpreted by this Court in accordance with authority granted by Congress to determine how and what claims shall be allowed under equitable principles . . ."

Michigan v. United States, 317 U. S. 338, 87 L. Ed. 312, 63 S. Ct. 302 (holding the federal estate tax lien superior to subsequent local tax liens):

> ". . . The establishment of a tax lien by Congress is an exercise of its constitutional power 'to lay and collect taxes.' Article 1, §8 of the Constitution. United States v. Snyder, 149 U. S. 210, 37 L. Ed. 705, 13 S. Ct. 846. And laws of Congress enacted pursuant to the Constitution are by Article 6 of the Constitution declared to be 'the Supreme Law of the Land; and the Judges in every

State shall be bound thereby any Thing in the Constitution or Laws of any State to the Contrary notwithstanding.'

". . . Hence it is not debatable that a tax lien imposed by a law of Congress, as we have held the present lien is imposed, cannot, without the consent of Congress, be displaced by later liens imposed by authority of any state law or judicial decision. United States v. Snyder, 149 U. S. 210, 37 L. Ed. 705, 13 S. Ct. 846, *supra;* United States v. Greenville (C. C. A. 4th), 118 F. 2d 963."

United States v. New Britain, 347 U. S. 81, 98 L. Ed. 520, 74 S. Ct. 367 (1954);

In re Freeze-in Manufacturing Corporation, 128 Fed. Supp. 259 (E. D. Mich. 1955).

The Bankruptcy Act contemplates a uniform system of priorities in distribution.

United States v. Sampsell, 153 F. 2d 731, 735 (9th Cir., 1946).

II.

The Federal Rule Is That the Lien That Is First in Time Is First in Right. Under This Rule Appellant's Lien Should Have Been Given Priority Over the Junior Liens of Appellees.

The applicable federal tax lien statutes are I. R. C., Sections 3670 and 3672.

I. R. C. 3670 (formerly R. S. 3186, now 26 U. S. C. A. 6321) makes federal taxes a lien on all property of the taxpayer. I. R. C. 3672 (now 26 U. S. C. A. 6323) makes the federal lien inferior to a mortgage lien which attached before recordation of the federal lien. These statutes read as follows:

I. R. C. 3670, 26 U. S. C. A. 6321:

> "If any person liable to pay any tax neglects or refuses to pay the same after demand, the amount (including any interest, additional amount, addition to tax, or assessable penalty, together with any costs that may accrue in addition thereto) shall be a lien in favor of the United States upon all property and rights to property, whether real or personal, belonging to such person."

I. R. C. 3672, 26 U. S. C. A. 6323:

> "(a) Except as otherwise provided in subsection (c), the lien imposed by section 6321 shall not be valid as against any mortgagee, pledgee, purchaser, or judgment creditor until notice thereof has been filed by the Secretary or his delegate . . ."

Applying I. R. C. 3670, the Supreme Court has held that it establishes the rule that the lien that is first in time is first in right.

United States v. New Britain, 347 U. S. 81, 98 L. Ed. 520, 74 S. Ct. 367 (1954), is very similar to the instant case, except that it was a mortgage foreclosure action, not a bankruptcy case. There were mortgage and judgment liens which came before unrecorded federal tax liens. Some of the federal tax liens came before local tax liens, others did not. The fund was insufficient to pay all lien claimants in full. State law purported to make the local tax liens paramount. The state court had ordered the local tax claims paid ahead of all other claims. The United States appealed. The Supreme Court reversed, holding that Congress by I. R. C. 3670 had intended to enact the universal equitable rule "first in time, first in right," and priority of payment should be determined according to the order of time. The opinion reads in part:

> "Obviously, the State cannot on behalf of the City impair the standing of the federal liens, without the consent of Congress. Michigan vs. United States, 317 U. S. 338, 340, 87 L. ed. 312, 314, 63 S. Ct. 302; United States vs. Oklahoma, 261 U. S. 253, 260, 67 L. ed. 638, 644, 43 S. Ct. 295; United States v. Snyder, 149 U. S. 210, 214, 37 L. ed. 705, 706, 13 S. Ct. 846. On the other hand, the federal statutes do not attempt to give priority in all cases to liens created under the paramount authority of the United States. The statute creating the federal liens here involved, I. R. C., §3670, does not in terms confer priority upon them.
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> * * * * * * * *
>
> "It does not follow, however, that the City's liens must receive priority as a whole. We believe that

priority of these statutory liens is determined by another principle of law, namely, 'the first in time is the first in right.' As stated by Chief Justice Marshall in Rankin v. Scott (U. S.) *supra*:

> " 'The principle is believed to be universal, that a prior lien gives a prior claim, which is entitled to prior satisfaction, out of the subject it binds, unless the lien be intrinsically defective, or be displaced by some act of the party holding it, which shall postpone him in a Court of law or equity to a subsequent claimant.' (12 Wheat., at 179.)
>
> "This principal is widely accepted and applied, in the absence of legislation to the contrary. 33 Am. Jur. Liens, §33; 53 C. J. S., Liens §10b. *We think that Congress had this cardinal rule in mind when it enacted §3670, a schedule of priority not being set forth therein.* Thus, the priority of each statutory lien contested here must depend on the time it attached to the property in question and became choate." (Emphasis added.)

The same rule applies in bankruptcy, where a uniform equitable system of distribution is contemplated.

In re Freeze-in Manufacturing Corporation, 128 Fed. Supp. 259 (E. D. Mich., 1955);

United States v. Sampsell, 153 F. 2d 731, 735 (9th Cir., 1946).

Cases relied on by the Referee [R. 18-20] and other cases reaching the same result[1] purport to apply both state and federal law, and justify the result as being the

[1]Typically, *Southern Ohio Savings Bank v. Bolce,* 165 Ohio St. 201, 135 N. E. 2d 382 (1956).

"most equitable" under the circumstances. The result is not, however, consistent with federal law and cannot be supported by state law, which is powerless to override federal law. A reading of these decisions indicates that the motivating factor has been the concern of the judges to secure the revenues of their local governments, and that "equity" is invoked as a euphemism to disguise the fact that they are not applying state law, but rather are misapplying federal law.

Congress has made no enactment as part of the Bankruptcy Act specifying the order of priority for the payment of secured claims. Priority of secured claims should therefore be determined according to the order of their priority in time. This is the rule that the Supreme Court declared in the *New Britain* case, and it should be followed in the absence of special statute. Under no other rule can bankruptcy administration be uniform, equitable or predictable.

The order of priority of liens in bankruptcy should not be determined by the zeal of the individual referee or judge to see that local taxes are paid, or by the accident that the lien claims may or may not include a federal lien or a prior mortgage. For example, in a typical case where the federal tax lien equals or exceeds the funds available for distribution, local taxes clearly could not be paid unless there were also a prior mortgage superior to the federal lien. Why should the fact that there is a prior mortgage entitle the local tax lien to payment ahead of both the mortgage lien and the federal lien? Congress could not

have intended any such result. In the instant case, how can the existence of a local tax lien justify the subordination of appellant's lien to the federal lien, to which appellant's lien is superior? How can the existence of appellant's mortgage lien justify the full satisfaction of the local tax lien ahead of the federal lien to which it is inferior?

How can the Referee's order be called equitable when it directs payment of the local tax lien out of money set aside for the payment of appellant's prior mortgage? Does the sanctity of a citizen's contract rights mean nothing? Is that sanctity to be tossed aside in the interest of collecting local taxes? Suppose the proceeds of sale only equaled the local tax lien, and the contract lien also equaled the local tax lien. Is it equitable to wipe out a prior contract lien in favor of a junior tax lien?

The plain fact is that the rule contended for by appellees is not an equitable or even "the most equitable" solution, that it leads to confusion in administration and uncertainty of titles, and grossly impairs the security of lien creditors. Until such time as Congress chooses by appropriate legislation to confer an absolute priority on local tax liens, bankruptcy courts should apply the first in time, first in right rule according to federal law as construed by the Supreme Court. The Referee's failure to have done so in this case is judicial legislation.

III.

The Referee Should Have Abandoned the Property, Since Its Value Was Insufficient to Produce an Equity for General Creditors. The Order Appealed From Is Inequitable Because It Impairs Appellant's Security Without Any Benefit to the Bankrupt Estate.

It is a fundamental rule of bankruptcy administration that the priority right of a secured creditor in lien property should be protected and preserved unimpaired. Such right extends to the interest as well as to the principal of a secured claim. Title to the bankrupt's estate passes to the trustee subject to existing encumbrances. The trustee has no interest in lien property except to obtain an equity for unsecured creditors.

Case v. L. A. Lumber Products Co., 308 U. S. 106, 116, 84 L. Ed. 110, 120, 60 S. Ct. 1 (1939);

Consolidated Rock Products v. Du Bois, 312 U. S. 510, 527, 85 L. Ed. 982, 994, 61 S. Ct. 675 (1940);

Institutional Investors v. Chicago, Mil. etc. R. R. Co., 318 U. S. 523, 546, 87 L. Ed. 959, 997, 63 S. Ct. 727 (1942);

6 Remington *Bankruptcy,* sec. 2780;

6 Am. Jur. *Bankruptcy,* sec. 933.

The value of the property was more than sufficient to pay appellant's secured claim as to both principal and interest ($361,881.48). The property was sold by the trustee free and clear of liens for $382,500.00. The record shows that there was no hope of realizing a surplus for general creditors. The referee should have ordered the trustee to abandon the property, so as to permit appellant to proceed with foreclosure and recover the full

amount of the indebtedness secured by its trust deed. In a foreclosure action in the state court, appellant's prior mortgage lien would be ordered paid first, there being no conflict of liens because appellant's lien is superior to the federal lien and the surplus, after payment of appellant's lien, would be sufficient to pay the County tax lien. Conflicting claims that might then arise to the surplus would be the proper subject of litigation between the County and the United States, and would not concern appellant.

The order appealed from is inequitable in the extreme, not only because it substantially impairs appellant's security without any benefit to the bankrupt estate, but because it results in using appellant's property to pay the bankrupt's taxes owed the United States and Los Angeles County. This result is contrary to every principle of equity and constitutional law. What we are saying has been clearly stated by the California Supreme Court in *National Ice Co. v. Pacific Fruit Express,* 11 Cal. 2d 283, 291:

> "As a legal deduction, it has been judicially declared that a tax constitutes a debt owed by the person upon whom such tax has been legally imposed; and aside from equitable considerations (which here are not involved), to baldly legislate that without, and in the absence of either due or any process of law, a legal debt that is owed by one person must be paid by another, is quite at variance with ordinary notions of that which may be termed the administration of justice."

IV.

Appellant's Lien Is Entitled to Priority Over the County's Tax Lien Under California Law.

Under the controlling California statute, Civil Code, sec. 2897, appellant's lien is entitled to priority over the county tax lien, which attached almost 10 years after appellant's trust deed was recorded. This section reads:

> "*Priority of liens.* Other things being equal, different liens upon the same property have priority according to the time of their creation, except in cases of bottomry and *respondentia.*"

It has long been settled in California that tax liens are not entitled to priority over pre-existing contract liens unless they are given such priority by statute.

Guinn v. McReynolds, 177 Cal. 230, 170 Pac. 421 (1918):

> "The general rule for fixing the relative rank of liens is declared by section 2897 of the Civil Code, which declares that 'other things being equal, different liens upon the same property have priority according to the time of their creation, except in cases of bottomry and *respondentia.*' This rule will govern unless, in any given case, the statute prescribes otherwise."

H. O. L. C. v. Hansen, 38 Cal. App. 2d 748, 102 P. 2d 417 (1940):

> "The decisions in both the Guinn and Bolton cases dispel any doubt as to whether California follows the rule of law that tax liens are *ex proprio vigore* superior to a pre-existing mortgage or other contract liens. These cases definitely hold that a para-

mount lien for unpaid taxes depends solely upon legislative enactment."

Fresno County v. Commodity Credit Corporation, 112 F. 2d 639 (9th Cir. 1940):

> ". . . Whatever may have been said concerning the 'superior dignity' principle in earlier cases on liens on real property is overruled by the holding in Guinn v. McReynolds, 177 Cal. 230, 232, 170 P. 421, 422, where a real estate mortgage lien was held superior to a subsequently created tax lien on the same property, not expressly made a first lien, for expenditures for eradication of disease and pests in orchards and elsewhere."

Although many other states have such statutes, there is no statute in California purporting to make the lien for county taxes paramount or giving it priority over pre-existing contract liens. The California statutes are restricted to declaring the effect of *tax deeds.* Since no tax deed is involved in this case, those statutes are irrelevant. The question here is one of priority. It is immaterial that foreclosure would not wipe out the county tax lien, since the bankruptcy court's order legally cancelled the lien.

The Referee's order should be reversed because appellant's lien is entitled to priority under the only California statute dealing with priorities.

V.

State Law Should Have Been Disregarded Since It Would Be Inequitable to Give the County Tax Lien Priority Over Appellant's Lien.

Any state statute giving a tax lien priority over a pre-existing contract lien is an act of a sovereign exercising superior force. It cannot be justified on any equitable principle. If California law is what the Referee erroneously found it to be, he should have disregarded California law.

It is well settled that a state statute that is inconsistent with the principles of equity may be disregarded by a bankruptcy court.

U. S. Trust Co. v. Zelle, 191 F. 2d 822 (8th Cir. 1951);

Vanston Bondholders Protective Committee v. Green, 329 U. S. 156, 91 L. Ed. 162, 67 S. Ct. 237 (1946).

VI.

Interest Should Have Been Allowed on Appellant's Claim to the Date of Payment, Since the Security Was Sufficient to Pay Both Principal and Interest.

In *United States v. Sampsell,* 153 F. 2d 731 (1946), this court held that interest should be allowed from the date of bankruptcy to the date of payment of a secured claim, where the security was sufficient to pay both principal and interest. The rule so established for the Ninth Circuit was in accordance with the decision of the Supreme Court in *Coder v. Arts,* 213 U. S. 223, 53 L. Ed. 772, 29 S. Ct. 436 (1908).

In 1946 the Supreme Court decided *Vanston Bondholders Protective Committee v. Green,* 329 U. S. 156, 91 L. Ed. 162, 67 S. Ct. 237, holding that, although the security was sufficient, interest on unpaid interest should not have been allowed after the date of bankruptcy on equitable principles, since interest on unpaid interest was in the nature of a penalty for late payment, and payment of simple interest had been deferred by order of court. It is to be noted that in this case *simple interest was allowed to the date of payment of the secured claim,* and the Supreme Court did not purport to depart from the rule that the allowance of such interest was proper.

In *Pacific States Corporation v. Hall,* 166 F. 2d 668 (1948), this court affirmed an order denying interest on a secured claim after the date of bankruptcy, because the record afforded no basis for a determination that such denial was improper. The *Vanston* case was cited as

supporting the proposition that interest might be allowed where the security was sufficient:

> "Appellant insists, however, that equitable principles may be invoked to award interest to a secured creditor subsequent to the filing of a petition in bankruptcy where the value of the security is in excess of the principal and interest due, and where such award will not be unfair to subordinate creditors. Vanston Bondholders Protective Committee v. Green, 329 U. S. 156, 167 S. Ct. 237. From the record before us, the value of the security and the relative equities between the secured creditor and the subordinate creditors cannot be determined."

In *Beecher v. Leavenworth State Bank,* 192 F. 2d 10 (1951), this court was presented with a case in which it would have been inequitable to have allowed interest after the date of bankruptcy. *It does not appear from the report that the value of the security was sufficient to cover both principal and interest.* The estate had been in the courts for years; the report suggests that the creditor may have been obstructive and responsible for some of the delay in the payment of its claim, as well as that a high rate of interest had been secured by taking advantage of the debtor's financial embarrassment prior to bankruptcy. Interest after the date of bankruptcy was properly denied except from the income from the security or any surplus remaining after all other claims were paid. On the record before the court the decision was undoubtedly correct and was in accordance with precedent. However, in a footnote (192 F. 2d at 14) the court remarked by way of dictum that its decision in *United States v. Sampsell* had been necessarily overruled by *Vanston.*

Courts in other circuits have been practically unanimous in holding that the *Vanston* decision did not change

the rule that where the security is sufficient interest should be allowed after bankruptcy, unless the record shows that such allowance would be inequitable.

> *U. S. Trust Company v. Zelle*, 191 F. 2d 822 (8 Cir. 1951);
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> *In re Macomb Trailer Coach*, 200 F. 2d 611 (6 Cir. 1952);
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> *Georgia, Florida & Alabama R. Co. v. Bankers Trust Co.*, 170 F. 2d 733 (5 Cir. 1948);
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> *Oppenheimer v. Oldham*, 178 F. 2d 386 (5 Cir. 1949);
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> *Littleton v. Kincaid*, 179 F. 2d 848 (4 Cir. 1950);
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> *In re Riddlesburg Mining Co.*, 224 F. 2d 834, 839 (3 Cir. 1955);
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> *Eddy v. Prudence Bonds Corporation*, 165 F. 2d 157 (2 Cir. 1947);
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> *In re Worden*, 107 Fed. Supp. 496 (W. D. Ky. 1952);
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> *In re Tele-tone Radio Corporation*, 133 Fed. Supp. 739, 749 (D. C. N. J. 1955);
>
> *In re International Hydro-Electric System*, 101 Fed. Supp. 222 (D. C. Mass. 1951).

It will have been noted that the actual decisions of this court in *Sampsell, Pacific States* and *Beecher* (as opposed to its unfortunate dictum in *Beecher*) are consistent with the rule of the *Vanston* case as construed in other circuits. Yet we understand that referees and District Judges in the Ninth Circuit have felt constrained, as did the Referee in the instant case [R. 22], to follow the footnote and to disallow post-bankruptcy interest, even when the record shows that the security is sufficient.

The question is, what does the footnote mean? We submit that all this court intended to convey by the footnote was that *Sampsell* was no longer the law in this circuit to the extent that it had held that post-bankruptcy interest must be allowed in all circumstances where the security was sufficient, even when on the record such allowance would be inequitable. It is not to be supposed that this court could, by mere dictum, have intended to establish a rule contrary to its own previous decisions and contrary to the rule of the Supreme Court as construed in all other circuits.

In the instant case, the Referee's order finds no support in the record. There is a total absence of those features which compelled the disallowance of post-bankruptcy interest in the *Beecher* case. Here, the record affirmatively shows that the proceeds of the sale of the security were more than sufficient to pay principal and interest on appellant's claim. The Referee found as a fact that appellant did nothing to delay payment of its claim and cooperated at all times in the administration of the estate [R. 24-25]. Appellant's trust deed was executed 9 years before the debtor went into bankruptcy. The record is devoid of any suggestion that the rate of interest is extortionate or that any advantage was taken of the debtor during an interval of financial embarrassment prior to bankruptcy, as in the *Beecher* case. The Referee's order is of no possible benefit to general creditors, but is simply a windfall to the United States, whose lien is clearly subordinate to appellant's lien by statute.

There being no equitable reason whatsoever for disallowing interest on appellant's claim from the date of bankruptcy to the date of payment, the Referee's order should be reversed.

Conclusion.

The order appealed from is inequitable because it appropriates appellant's money for the payment of the county tax lien, and impairs appellant's security without any benefit to the bankrupt estate. It is erroneous because it ignores controlling federal law to give the county tax lien priority of payment over the superior liens of appellant and the United States, and subordinates appellant's lien to the lien of the United States. It subordinates appellant's prior mortgage lien to the county tax lien, although appellant's lien is entitled to priority by California law as well as by federal law. Affirmance will lead to confusion and uncertainty in bankruptcy administration, and will give the lien for county taxes an absolute priority to which it is not entitled by any statute. The order can only be justified as a vindication of state sovereignty; that is no proper function of a bankruptcy court unless and until Congress has made it such.

The order is also erroneous in denying appellant interest on the principal amount of its claim to the date of payment, the proceeds of the sale of the security being sufficient and there being no equitable reason for disallowing interest.

The order should be reversed, with directions to pay appellant's claim in full, including the balance of $15,384.10 withheld and $10,657.74 interest to the date of payment.

Respectfully submitted,

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and

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